Statement by the Group CEO

2012 proved to be another very good year for SpareBank 1 SMN. A Group pre-tax profit of NOK 1,355m and a post-tax return on equity of 11.7 per cent are above the levels planned for the year. At the start of 2013 there are grounds for optimism for the profit trend this year too.

Profitable growth

In 2012 we saw continued sound growth in all customer segments. This confirms the Bank's solid position as market leader and the strength of the SpareBank 1 concept. For 2013 and coming years the Bank's new tier 1 capital target and capital plan will impose restrictions on lending growth, especially to corporates. We are however in a position to meet the financing needs of our customers in Trøndelag and in Møre and Romsdal in view of the slight reduction in demand in evidence at the start of 2013. SpareBank 1 SMN will not weaken the solid market position it has established. We are also prepared to meet the need for house building and home loans in towns in our catchment area where the housing market is out of balance and shows a major need for new housing construction.

New regulatory requirements, application for advanced IRB status

In the fourth quarter of 2011 the Norwegian authorities gave very clear signals of tighter capital requirements for Norwegian banks. A common equity tier 1 ratio of at least 9 per cent was to be achieved by 1 July 2012. We met this requirement, but the authorities subsequently gave notice of a far higher level of financial strength for banks in the slightly longer term. This has so far not been clarified. Moreover, the authorities signalled an early introduction of Basel III in Norway, based on the supposition that Norwegian banks are in a far better position to adapt to this new, more stringent regulatory regime than the European banking and financial system which still faces major challenges related to the European sovereign debt crisis. We share the Norwegian authorities' assessment of the respective positions. Even so, we believe that early introduction in Norway will weaken Norwegian banks' competitiveness vis-à-vis foreign competitors.

At the end of 2012 signals emerged of the Norwegian authorities' wish to reduce the risk of a possible home loan bubble by imposing on Norwegian banks a large increase in risk weights on home mortgage loans. For our part this entails an increase from 11 to 35 per cent in mortgage weights, corresponding to a tier 1 capital effect of 1.5 percentage points. Part of the idea behind this is that higher capital charges will limit the growth of lending for residential purposes and thereby reduce the risk of a housing bubble developing in Norway. We agree that bubble tendencies in the Norwegian economy should be prevented, likewise that a sharp reduction of house prices in Norway could have negative consequences for the wider economy. We are however uncertain whether introducing a mortgage weighting specific to Norway will have the intended effect. Both we and other Norwegian banks adjust by curbing loans to corporates with the highest risk weights. In addition we will ensure that a higher proportion of the profit for the year is retained, which among other things reduces funds available for non-profit causes. And, with 35 per cent mortgage weightings, the Bank's risk models are undermined, since the risk to banks posed by home mortgage loans is low, indeed far lower than this risk weight level would imply.

SpareBank 1 SMN is concerned to act responsibly and to come across as indisputably solid. This year we will apply for permission to use the advanced IRB approach and must reasonably be able to count on risk weights on corporate loans that better reflect the underlying risk than the today's IRB models do. The Bank's trend in defaults and losses in recent years confirms the Bank's professionality where risk management is concerned. We would like to see this reflected in risk weights and bring us to par with our competitors now enjoying advanced IRB status.

Capital plan and new common equity tier 1 target

In spring 2012 we launched a rights issue which was oversubscribed by more than 50 per cent. Later we made a stock placing with the foundation Sparebankstiftelsen SMN and a smaller placing with the US-based Wellington Management Company. This put us in adherence with the required minimum 9 per cent tier 1 ratio by 1 July 2012.

In keeping with signals from the Norwegian authorities, the Board of Directors have adopted a new common equity tier 1 ratio target of a minimum of 12.5 per cent by the end of 2015. The Board has at several board meetings discussed its way to a plan for how the new capital target is to be attained. The capital plan was published in conjunction with the preliminary financial statements for 2012. The plan was well received, and the price of the Bank's equity certificate rose firmly. The plan outlines a series of measures to attain the above goal. A rights issue is not a part of the capital plan. In other words, we propose to achieve a 12.5 per cent common equity tier 1 ratio by:

- increased incomes
- continued low losses on lending
- increased retention ratio, i.e. a lower level of gifts to non-profit causes and a level of cash dividend limited to 25-30 per cent of equity certificate holders' share of net profit
- sale of assets that tie up core capital, but are not critical to Group operations
- increased return from SpareBank 1 Gruppen
- use of advanced IRB and thereby some adjustment of risk weights on loans to corporates etc.

The capital plan incorporates the assumption of 35 per cent risk weights on home mortgage loans and retention of our 33 per cent stake in BN Bank. Since the New Year we have divested shares in Polaris Media and signed an agreement to sell our stake in Bank 1 Oslo Akershus. These measures are enshrined in the capital plan.

Money market funding not a particular challenge for SpareBank 1 SMN

At the end of last year we saw far better access to money market funding. Both access to funding and the market price are substantially improved for our part. This led to our decision in February 2013 to issue a senior bond of EUR 500m. We will continue our effort to ensure that SpareBank 1 SMN is well known and carries out issues in this market; by that means we expect our relative pricing to improve. Through the year we also saw favourable conditions for SpareBank 1 Boligkreditt and an increase in customer deposits. Given somewhat limited lending growth ahead, we expect funding in the years ahead to continue to be available at steadily lower cost.

Best for customer experience

There was a tight focus on the Bank's strategic improvement projects in 2012 and these projects will be carried forward into 2013.

As from 1 January 2013 the Bank's organisation plan is changed. We have left the divisional model and established a model comprising three customer-facing units (Group Customers, Offices and E-business), two supply units (Products and Processes, HR) and Group Finance. We have concurrently redefined the manager role and reduced the number of managers from 116 to 48 at the parent bank. In 2013 we will focus on the adviser role. Our aim is for these projects to inject new energy into the organisation and make added resources available for value creation and fewer resources to support functions. We already see indications of increased productivity in the organisation, thereby assuring a better customer experience as well as reducing resource use and cost growth at the Bank.

Our ability to upgrade the adviser role is absolutely key. The adviser is the creator of value and the owner of the customer relationship. We want as many as possible of our capable staff to work with customers and sales, and to experience a personal development in the adviser role that is as at least as interesting and rewarding as taking on an executive role. By redefining the manager role and reducing the number of managers we have freed up many of our best staff to work with customers. We are making more adviser capacity available to small and large corporates, in particular in Trondheim and Ålesund. It is my conviction that our customers will enjoy a better customer experience and that we will achieve increased sales and increased earnings.

We will reduce the Group's operating expenses

We have seen strong cost growth in recent years. This is an unsustainable trend. We have built up the capacity and competence needed to ensure our profitability and market leader position. This has cost us. In terms of competence the Bank is now at a very high level. We have invested heavily in authorisation of our advisers and a high degree of professionality is present in all core processes. Good risk management and low losses are also a feature of our business. That is why we now venture to reduce cost growth by reducing the number of person-years worked, putting in place improvements and streamlining work processes as well as reintroducing stronger cost management at all levels. The aim is to reduce cost growth at the parent bank to below 3 per cent annually and to reduce the number of person-years worked at the parent bank by a minimum of 75 by year 2015.

Well-functioning subsidiaries

The Group's subsidiaries showed solid progress in 2012, as previously. The largest ones, EiendomsMegler 1 Midt-Norge, SpareBank 1 SMN Finans and SpareBank 1 SMN Regnskap, are strengthening their market position and profitability.

The Bank's monetary gift work

We will ahead allocate less to monetary gifts than we have done in recent years, and we will seek to put our gift work to maximum effect despite reduced appropriations. We are still unparalleled as the largest private contributor to business and community development in Trøndelag, and have an important role to play in Møre and Romsdal where other savings banks also have substantial gift activities. The challenge is to find a good combination of causes of that benefit the community and a strengthening of the donor's market position through monetary gift work.

SpareBank 1 alliance – our most important strategic foundation

Disregarding a tax-related one-time effect for SpareBank 1 Livsforsikring, SpareBank 1 Gruppen's companies together delivered a satisfactory profit contribution in 2012. Prospects for 2013 are even better. We are working with an amalgamation of our insurers, a major improvement programme has been initiated at ODIN Forvaltning and SpareBank 1 SMN Markets has taken its place as one of the country's leading brokerage houses. Further, SpareBank 1 Gruppen's board of directors established in January 2013 a comprehensive improvement programme in response to clear signals from all owners in favour of simplification, reduced costs and a greater effect of the banking collaboration.

I view the cohesion in the alliance as very strong, and there are currently no significant challenges on the owner-front, rather a strong consensus and will to further develop SpareBank 1 as the country's second largest financial group and as leading banks for the regions of Norway. There is reason to believe that SpareBank 1 SMN in 2013 and further ahead will see significantly higher profit contributions and effects of the collaboration within the SpareBank 1 Alliance.

Concluding comment

We have delivered solid performances in recent years, made an active contribution to the development of our market area and delivered good return to our owners through dividend and, more recently, a higher value of our equity instrument. The Bank has good risk management and incurs low defaults and low losses. We are continually strengthening our position in both the retail market and the corporate market. The entire financial industry will need increased income as a result of new capital requirements, and there are grounds to expect that SpareBank 1 SMN will also have a basis for raising the Bank's interest margins and income. We believe there are grounds for optimism 2013 too.

What path the economy will take is the ever present uncertainty. So far our market area has been negligibly affected by the international sovereign debt and financial crisis. With brighter prospects in evidence in Europe, there is no reason to believe that we will be affected in 2013 either. But it is important to have in place sound emergency plans in the event of an economic reversal. We expect continued growth and profit improvement in the current year, as previously.